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USDOC FOR DAS LEVINE AND ITA/MAC/AP/MCQUEEN  
TREASURY FOR OASIA/ISA KOEPKE AND DOHNER  
STATE PASS CEA FOR BLOCK  
STATE PASS FEDERAL RESERVE BOARD FOR JOHNSON/SCHINDLER  
STATE PASS SAN FRANCISCO FRB FOR CURRAN  
STATE PASS NEW YORK FRB FOR DAGES/CLARK  
STATE ALSO PASS USTR STRATFORD/WINTER/MCCARTIN  
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SUBJECT: The Woes of Foreign Banks in Southern China

Ref: Beijing 3454

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11. (SBU) Summary: Foreign banking representatives in Guangdong province expressed continued frustration at breaking into domestic markets, while acknowledging the easing of restrictions on paper. The banking officials cited administrative hurdles and a lack of transparency in regulations and guidelines as sources of concern. To combat a discouraging business environment, several foreign banks have formed a collective to dialog with regulators and competitor domestic banks. End Summary.

All Banks Are Equal, Except for Some

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12. (SBU) During a February 16 meeting with the Consul General, representatives from Bank of America, Wachovia, Citibank, Scotiabank, Deutsche Bank, and Bank of Montreal spoke of China's compliance with its WTO commitments with respect to the banking sector, including prospects for developments after December 2006 when theoretically foreign banks should be able to operate on the same terms as their domestic counterparts. These will include foreign banks having rights to conduct an extensive RMB business and foreign banking presence throughout the country beyond the thirty-two cities currently open to foreign banks. In Guangdong, for example, only Guangzhou, Shenzhen, Shantou, and Zhuhai are currently open. Credit card services are still closed to foreign banks, and new guidance is expected in December 2006, though the foreign bankers at this meeting do not know what to expect.

13. (SBU) The Citibank official stated that even after December 2006, local banks will still be at an advantage because of their established networks and their connections with local governments. He added that a long application process to open new branches allows local governments to control the speed of expansion. As a result, local banks can be more aggressive than their foreign counterparts, as they face fewer requirements and less stringent risk

analysis when processing loans. One way that foreign banks circumvent the stiff competition is by investing directly in local banks. Foreign banks currently represent only about two percent of the nation's market share.

#### When in Doubt, Unite

14. (SBU) Foreign bankers in Guangdong have formed a semi-official association when they joined the Guangdong Bank Association as a committee within the association in January 2005. Though the Bank Association remains the umbrella organization, the foreign banking members operate by their own guidelines, and the committee has five-member board of directors elected annually. The foreign bankers jointly communicate with regulators through this committee to seek clarification of rules, and have a limited dialogue with domestic banks in the association. The Deutsche Bank representative noted that the Guangdong foreign bankers group differs from the one in Shanghai, where there is more dialogue overall.

#### Bank Shots

15. (U) When asked to list their top areas of concern, the bankers responded: transparency in the understanding of and compliance with regulations; the relatively large number of regulators in the banking sector with their own regulations; the difficulty and slowness associated with repatriation of foreign currency earnings; administrative hurdles in setting up new branches; China's foreign exchange policy; and shortages of skilled professionals. The bankers noted that local banks are a good source of experienced labor, and that internal training is an option.

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#### One Niche Market is Two in the Bush

16. (SBU) Foreign banks are able to offer specialized products, allowing them to operate in a niche market. Citibank described some products including forward rates (extending 6 or 12 months into the future), cross-currency rates, derivatives, commodity hedging, and deposits linked with outside investments. The Bank of Montreal representative stated that Chinese regulatory officials are eager to learn about these niche products, while the Citibank official added that his institution has offered training on derivatives to Chinese officials.

#### Don't Bank On It

17. (SBU) When asked about the role of compliance officers, the banking officials stated that, due to lack of transparency in the development of new regulations as well as a dearth of clear interpretation guidelines, there is a growing demand for good compliance officers. The Deutsche Bank official stated that Chinese regulators themselves are a common source for compliance personnel, adding that former regulators also would have good "guanxi" -- relationships -- with their former colleagues.

18. (SBU) The bank officials explained that regulations are issued on a nationwide scale through several different regulatory bodies, but disagreed over the extent of transparency in the regulatory process. For instance, the Citibank official said he believes the National Development and Reform Commission (NDRC) has wielded a significant influence for many years but is mostly a closed process that invites input from Beijing-based think tanks. The Deutsche Bank representative noted that transparency has improved, as NDRC has publicized and sought feedback for new policies in the last two years. The representatives agreed that local regulators normally are not consulted in the process, and often are unsure how to interpret the regulations. Consequently, different cities practice different interpretations of national guidance, though the Bank of

Montreal representative commented that local officials can be quite defensive if foreign banks highlight the city-to-city differences.

¶10. (SBU) The committee that the foreign banks created under the Guangdong Banking Association has helped get a degree of clarity about the interpretation of regulations. The process works essentially with the committee providing bank regulators with the committee's thoughts about practical compliance with the regulations. Almost invariably there is no response from local bank regulators, which the foreign banking community takes as agreement on the interpretation. The fact that local interpretations are common, however, leaves many foreign bankers in Guangdong with considerable unease that one day they may come to the office to find a notice of violation of a regulation and a substantial fine to boot.

#### Shenzhen and Guangdong Development Banks in the News

¶11. (SBU) Recently, the media reported that Jeffrey Williams resigned as president of the Shenzhen Development Bank. Williams, an American, was the first foreign president of a Chinese bank. Participants at the lunch attributed his resignation to conflicts in management style and culture. Also recently, Citibank reportedly submitted its bid for a majority ownership of Guangdong Development Bank, while French and Chinese consortiums submitted competing bids. Milson Lau, General Manager of the Guangzhou Branch of Citibank, did not offer any new information on the deal, other than to comment that a decision is expected in a month or two.

Comment

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¶10. (SBU) While the bankers we spoke with have generally positive views about the quality of the provincial and local governments' banking regulatory personnel, the combination of administrative hurdles and lack of transparency favors local banks that already are entrenched in the economy. At the same time, however, the novelty of niche financial products, combined with recent efforts to create a unified voice, offer an opportunity for foreign bankers to begin creating their own "guanxi" and to expand their markets based on their comparative advantage -- developments that local regulators seem to want even as they wish domestic banks would speed up their abilities to be equally innovative.

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